Important Changes to the PRC Company Law in 2024

Part One: Corporate Governance Related Matters

22 January 2024

On December 29, 2023, the Standing Committee of the National People's Congress passed an amendment to the 2018 PRC Company Law, now known as the “2023 Company Law,” which will take effect on July 1, 2024. The following is a summary of the key changes to the corporate governance framework introduced by the 2023 Company Law. We will focus on the changes applicable to limited liability companies (有限责任公司 or “LLCs”), which is a corporate form that is commonly used by foreign investors for their subsidiaries in China.

1. Voting mechanisms for shareholders and board matters

   The old PRC Company Law allowed LLCs to establish their own voting mechanisms for shareholders’ meetings. It stipulated that a two-thirds majority vote is required for certain statutory reserved matters (which are amendments to the articles of association, dissolution, registered capital adjustments, change of corporate form and mergers or spin-offs). The approval thresholds for non-statutory reserved matters were not specified. The 2023 Company Law now requires a simple majority vote at shareholders’ meetings to approve the non-statutory reserved matters.

   The 2023 Company Law also stipulates that a board of directors’ meeting can only be convened with a quorum of more than half of the directors present. Resolutions of the board of directors also require approval from a simple majority of more than half of all directors.

   LLCs should review their articles of association to ensure that they will comply with the new legal requirements and make appropriate amendments where necessary. Shareholders’ agreements of LLCs (where applicable) should also be reviewed.

2. Employee representative on the board of directors

   The 2023 Company Law mandates that LLCs with 300 or more employees must include at least one employee representative on their boards, unless there is an employee representative on their supervisory boards. This applies to all LLCs, regardless of whether they are state-owned or privately owned. The scope of this regulatory requirement has expanded beyond the old PRC Company Law, in which only state-owned companies were required to have employee directors. LLCs that meet this threshold for the number of employees need to consider this requirement going forward.

3. Candidates for the position of legal representative

   The 2023 Company Law expands the pool of candidates eligible to be nominated as a LLC’s legal representative. Comparing with the old PRC Company Law, apart from the chairperson of the board (or
the sole executive director if the company did not have a board) and general manager of the LLC, any
director can now be eligible to be the legal representative. This should give LLCs more flexibility in the
appointment of their legal representatives.

4. Supervisory board (or supervisor) is no longer mandatory

The 2023 Company Law has changed the rules for supervisory boards or supervisors for LLCs.
Previously, all LLCs were required to have one supervisory board or supervisor to oversee the company’s
operations and management. The 2023 Company Law will bring in two major changes, as follows:

- LLCs may choose to form an audit committee within their directors to take over the role of a
  supervisory board or supervisor.
- “Small-scaled companies” or LLCs with “few shareholders” can choose not to have a supervisory
  board or a supervisor with the unanimous agreement of the shareholders.

Setting up and maintaining a supervisory board or the role of supervisor in LLCs can be administratively
cumbersome, especially for wholly owned subsidiaries. This change should reduce the administrative
burdens for investors as they can now establish and operate LLCs without appointing a supervisor or
have the ability to eliminate the role if one is already appointed or simply not to fulfil the vacancy after a
supervisor resigns.

5. Duties and personal liabilities of directors, supervisors, and senior management
(together the “SMPs”)

The 2023 Company Law made several changes to the duties and personal liabilities of the SMPs. We
have outlined some of the notable changes below:

a. Fiduciary duties of the SMPs

Compared with the old PRC Company Law, the “duty of loyalty” and the “duty of diligence” are more well-
defined in the 2023 Company Law. The duty of loyalty requires the SMPs to avoid conflicts of interest
and prevent themselves from abusing their positions for personal benefits. The duty of diligence
requires them to act with appropriate care in the company’s best interests. They must also disclose
transactions that involve their own interests, as well as those involving their close relatives and affiliates,
to the board or shareholders for approval as required by the articles of association. They are not allowed
to divert the companies’ business opportunities for their personal gain or compete with the companies
without permission from the boards or shareholders.

b. Personal liabilities of the SMPs

The 2023 Company Law outlines the personal liabilities specific to the matters below when the SMPs
perform their duties:

i. Liability of the directors and senior management to third parties
The 2023 Company Law retains the previous provisions that hold the SMPs liable for damages suffered by the companies arising from their violation of laws, administrative regulations, or the companies’ articles of association. Additionally, it introduces a new obligation, in which the directors and senior management (excluding supervisors) are liable to compensate the companies/third parties if their intentional acts or gross negligence have caused harm to third parties while performing their duties.

**ii. Liability of directors and senior management for not performing their duties independently**

The 2023 Company Law requires the directors and senior management to perform their duties independently and in compliance with the law. They must not follow directions or orders from the controlling shareholders or actual controllers that would harm the companies or other shareholders' interests. Any breach of this duty could result in joint and several liability with the controlling shareholders or actual controllers.

**iii. Liability of the SMPs for overseeing the registered capital contribution of the companies**

The 2023 Company Law re-establishes a five-year time frame for the shareholders to fully contribute the registered capital subscribed in LLCs. Directors are required to enforce capital contribution mechanisms by seeking payments, confirming the contributions of the shareholders, and issuing contribution demands to the shareholders in a timely manner. If the directors fail to perform these duties, which results in losses to the companies, they may face personal liability for damages.

In addition, shareholders are prohibited from withdrawing their capital contributions except through the legitimate process of registered capital reduction. Should an illegal withdrawal lead to losses suffered by the companies, the SMPs involved may be held jointly liable for damages with the shareholders. Furthermore, if a company unlawfully reduces its registered capital, which results in losses suffered by the company, the SMPs involved could be held liable.

**iv. Liability of the SMPs for unlawful profit distribution to shareholders**

The 2023 Company Law stipulates that if the company distributes profits to shareholders unlawfully, which results in losses suffered by the company, the SMPs involved could be held liable.

**v. Liability of the directors as the liquidation responsible persons**

The 2023 Company Law requires the companies’ directors to serve as liquidation responsible persons and form the liquidation committee within a stipulated time frame during the voluntary liquidation process. The liquidation committee should consist of the companies’ directors unless it is otherwise designated in the articles of association or a shareholders’ resolution. Directors are liable for any losses suffered by the company or its creditors during the liquidation process if they fail to fulfil their obligations as the liquidation responsible persons or members of the liquidation committee.

The SMPs should be aware of their responsibilities under the 2023 Company Law. LLCs may consider providing appropriate trainings to the SMPs on this subject matter.
Undoubtedly, the 2023 PRC Company Law will have an impact on the corporate governance of LLCs. Investors should be aware of the changes in order to comply with the new requirements. We expect there will be a series of more detailed rules and practice notes to provide further guidance on how the changes will be implemented in practice before the July 1, 2024 effective date. We will keep a close eye on the developments and post updates when they occur.

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